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UNCLAS HARARE 000960

SIPDIS

SENSITIVE

STATE FOR AF/S
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER
USDOC FOR 2037 DIEMOND
PASS USTR FLORIZELLE LISER
TREASURY FOR ED BARBER AND C WILKINSON
STATE PASS USAID FOR MARJORIE COPSON

1E. O. 12958: N/A

TAGS: [ECON](#) [ETRD](#) [EINV](#) [PGOV](#) [ZI](#)

SUBJECT: Zimbabwe's Looming Default Crisis

11. (SBU) Summary: Once this - or a future - GOZ eliminates negative real interest rates, local bankers expect borrowers to default en masse. The coming default crisis underlines how difficult it will be to rationalize Zimbabwe's distortion-laden economy. End Summary.

Only Decent Investment is Red Ink

12. (SBU) In real terms, interest rates are a whopping 200 percent negative (subtracting 250 percent inflation from a 50 percent nominal interest rate). One of the few good investments in this collapsing economy has been borrowing, then converting to hard currency. (The Zimdollar has fallen from Z\$ 346 to 2100:US\$ 1 in exactly one year.) Someday a GOZ will recognize the downsides of negative rates and allow them to rise above inflation. At that point, the President of the Zimbabwe Bankers Association believes few businesses or homeowners will be able to service debts (almost all carry variable rates). He expects massive foreclosures.

13. (SBU) How could the GOZ allow interest rates to get so out of sync with inflation? To some extent, it has relied on misguided economic counsel. Samuel Undenge, a rare economist in GOZ good graces, is frequently touted as an economic expert in the official press. He is such an evangelical believer in low borrowing rates that he took out newspaper advertisements in July 2002 arguing "it is lending rates which will stimulate the economy." He still insists the GOZ could turn this near-comatose economy around by dropping lending rates from 75 to 25 percent.

Comment

14. (SBU) No need to recite elementary economic theory here. Suffice it to say the economy has already milked any growth benefits from cheap financing. Now it is suffering the more damaging consequences of: a) capital flight to safe investment venues (banks in neighbor South Africa offer some of the world's highest real interest rates), b) resource diversion to unproductive activities, c) GOZ addiction to low-interest debt and d) depletion of Zimbabwe's once enviable savings rate. In sum, negative real interest rates have been a major cause of the plummeting Zimdollar. Sadly, it is unclear whether a post-Mugabe GOZ will be able to float interest rates upward while protecting vulnerable companies and homeowners.

Whitehead